

Matt Blunt
Governor



Michael N. Keathley
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Thomas J. Sadowski
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January 31, 2007

The Honorable Matt Blunt
The Honorable Members of the Legislature
Citizens of the State of Missouri

In accordance with generally accepted accounting principles, I submit to you the Comprehensive Annual Financial Report of the State of Missouri for the fiscal year ended June 30, 2006. This report was prepared by the Office of Administration, Division of Accounting, whose management is responsible for its contents.

The report is prepared to show the financial position and operating results of the State. The State's internal accounting controls provide reasonable assurance regarding the safeguarding of assets against loss from unauthorized use or disposal and the reliability of financial records for preparing financial statements. The concept of reasonable assurance recognizes that the cost of a control should not exceed the resulting benefit. We believe the data presented is accurate in all material respects and that all disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial activities have been included.

An annual audit of the basic financial statements is completed each year by the State of Missouri Auditor's Office. The State Auditor conducts the audit in accordance with generally accepted government auditing standards, and her opinion has been included in this report. The State Auditor conducts a "Single Audit" of all federal funds in accordance with the Federal Single Audit Act of 1984, and the U.S. Office of Management and Budget Circular A-133, "Audit of State and Local Governments and Non-Profit Organizations."

A narrative introduction, overview, and analysis of the basic financial statements is presented in the *Management's Discussion and Analysis (MD&A)* section of this report. This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

PROFILE OF THE GOVERNMENT

Missouri was organized as a territory in 1812 and was the second state (after Louisiana) of the Louisiana Purchase to be admitted to the Union. Statehood was granted on August 12, 1821, making Missouri the 24th state. The State encompasses 68,945 square miles.

The State operates under three branches of government: executive, legislative, and judicial. The executive branch consists of the Governor, Lieutenant Governor, Secretary of State, State Auditor, State Treasurer, and Attorney General. The legislative branch consists of 34 members of the Senate, and 163 members of the House of Representatives. The judicial branch is a three-tier court system. The Supreme Court, the State's highest court, has statewide jurisdiction; a court of appeals that consists of districts established by the General Assembly; and a system of circuit courts that has original jurisdiction over all cases and matters, civil and criminal.

The State provides a range of services in the areas of agriculture, education, health and social services, transportation systems, public safety, law enforcement, judicial systems, economic development, conservation and natural resources, labor relations, and general administration.

The State operates on a legally adopted budget in order to ensure compliance with legal provisions embodied in the annual appropriated budget passed by the General Assembly and approved by the Governor prior to the beginning of the fiscal year. If appropriations are not sufficient for a fiscal year, supplemental amounts are requested during the next legislative session by the same process that original appropriations are requested. Budgetary control is maintained at the departmental level. Expenditures cannot exceed the appropriation amount at the individual appropriation level. Also, the Governor has the authority to reduce the allotments of appropriations in any fund if it appears that the revenue estimate will not be met. Unexpended appropriations lapse at the end of each appropriation year, unless reappropriated to the following appropriation year.

The financial reporting entity of the State includes all of the funds of the primary government as well as component units for which the State is financially accountable. The transmittal letter, MD&A, and the financial statements focus on the primary government and its activities. Although information pertaining to the component units is provided, their separately issued financial statements should be read to obtain a complete overview of their financial position.

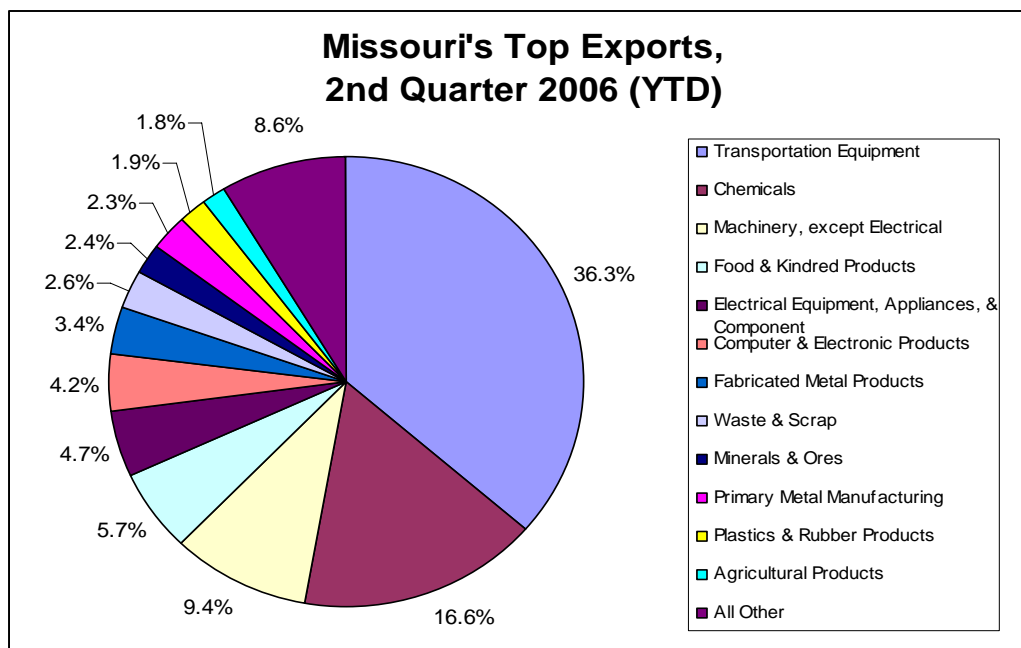
ECONOMIC CONDITION

State Economy

Missouri's economy has continued to remain strong and diverse, with Missouri having one of the most diversified economies in the nation. As a major manufacturing, financial, and agricultural state, Missouri's economic health is tied closely to that of the nation. The national economy grew at a vigorous pace during the last half of fiscal year 2006, but is expected to slow to an average pace during the first part of fiscal year 2007.

Missouri's personal income, which directly impacts individual income tax and sales tax, rose at a 5.3% rate during calendar year 2005. Personal income trends indicate that Missouri can expect continued growth during fiscal year 2007. Along with higher personal income, Missourians also enjoy the fifth lowest cost of living in the United States.

Exports by Missouri companies topped \$6.0 billion from January through June 2006, up more than 18% compared to the same period in 2005. Missouri set a state record for exports in 2005 with \$10.5 billion in total global sales, and looks to exceed that mark in 2006. Twelve product categories had over \$100 million in export sales for the second quarter of 2006. The graph below shows Missouri's top categories of exports.



Source: MERIC and the World Institute for Strategic Economic Research (WISER)

Missouri continues to become more competitive in the global marketplace, as can be seen by the upward trend in export totals for the last five years. Figures for Missouri export totals have risen from \$6.2 billion in 2001 to \$10.5 billion in 2005. Ongoing efforts to identify new international markets and trade opportunities for Missouri products will benefit the State's economy.

Long-Term Financial Planning

Missouri funding priorities include education, healthcare, public safety, and economic development. Continued efforts within State government to provide more efficient and effective customer service while using fewer resources will save money that can be used for education and healthcare programs.

Relevant Financial Policies

Article X of the Missouri Constitution imposes a limit on the amount of taxes that may be imposed by the General Assembly in any fiscal year. This limit is tied to total state revenues for each fiscal year and adjusted annually based on a formula which is tied to increases in the personal income of Missouri for certain designated periods. If the revenue limit is exceeded by 1% or more in any fiscal year, the excess revenue will be refunded based on the liability reported on state income tax returns. If the excess revenue collected is less than 1% of the revenue limit, the excess revenue shall be transferred to the General Revenue Fund.

The revenue limit can be exceeded by a constitutional amendment adopted by the people or if the General Assembly approves by a two-thirds vote an emergency declaration by the Governor. The State has refunded money to income taxpayers for fiscal years 1995 through 1999, but has not exceeded the revenue limit in fiscal years 2000 through 2006. The State does not expect the limit to be exceeded in fiscal year 2007.

Major Initiatives

Missouri will continue to focus on controlling the growth of mandatory programs through various cost-effective alternatives and streamlining government functions.

Education. Funding for education remains a top priority for Missouri. The fiscal year 2007 budget includes a \$173.4 million increase for public education as part of the revision to the school funding formula, and also a \$20 million increase for Missouri's public two and four year colleges and universities. Missouri's Department of Natural Resources has approved nearly \$9.3 million in low interest loans for schools and communities to make energy-efficiency improvements. These energy saving improvements allow school districts to improve classroom conditions for students and redirect the savings toward the priority needs of each school.

Health. The quality of healthcare continues to be a priority for Missouri. The Healthcare Technology Fund was created in 2006 to support projects to explore new and innovative ways that technology can improve the delivery of healthcare, reduce administrative costs, and eliminate waste and fraud. A task force was also established to analyze and develop recommendations to modernize Missouri's healthcare delivery system.

Public Safety. Ground breaking recently occurred for a new women's correctional center to replace one of the oldest facilities in the State system. The new Chillicothe Reception and Diagnostic Center will provide three times the capacity of the existing facility, as well as increase safety for Corrections employees and the public. The new facility is expected to open for operation by late 2008 or early 2009.

Over \$1.1 billion was allocated for road and bridge construction and maintenance, as part of a long range plan to improve highways using state gasoline tax revenues, sales tax revenues on motor vehicle sales and matching federal dollars.

Economic Development. The Missouri Energy Task Force was established to make recommendations for lessening Missouri's dependence on oil and other fossil fuels, as well as promote the development of alternative fuel sources in ways that strengthen the farm economy of rural Missouri. Missouri has also enacted legislation which establishes the Missouri Renewable Fuel Standard Act. This act requires most Missouri gasoline to contain at least 10% ethanol by January 1, 2008. Missouri farmers will benefit from the increased demand for their corn that will be used in the creation of ethanol. Missouri currently has four operating ethanol plants that produce approximately 160 million gallons annually.

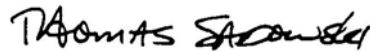
A new initiative has been developed to assist Missouri communities working to revitalize their downtowns and attract new private investment opportunities. The Downtown Revitalization and Economic Assistance for Missouri (DREAM) Initiative will help communities more efficiently and effectively engage in downtown redevelopment and revitalization efforts, thereby spurring growth and new jobs.

ACKNOWLEDGEMENTS

While the Office of Administration, Division of Accounting, is responsible for the contents of this report, no one division could do it alone. Many people were involved in the compilation of materials necessary to complete the report.

We want to issue a special thanks to all the personnel at the State agencies who provided us with information quickly and accurately so that we could issue the CAFR in a timely manner. We also owe thanks to the professionalism and dedication demonstrated by technical and management personnel within the State Auditor's Office, the State Treasurer's Office, Office of Administration, Information Technology Services Division, and the State Printing Center. We are greatly appreciative to all.

Sincerely,

A handwritten signature in black ink that reads "Thomas Sadowski". The signature is written in a cursive, slightly stylized font.

Thomas Sadowski, CGFM, CPA
Director